

No. 84-1274

Office - Supreme Court, U.S.

FILED

JUL 11 1985

ALEXANDER L. STEVAS,

IN THE
Supreme Court of the United States

OCTOBER TERM, 1985

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,

Petitioner,

v.

DIMENSION FINANCIAL CORPORATION, *et al.*,

Respondents.

On Writ of Certiorari to the United States
Court of Appeals for the Tenth Circuit

**BRIEF OF INDEPENDENT BANKERS
ASSOCIATION OF AMERICA
AMICUS CURIAE
IN SUPPORT OF PETITIONER**

LEONARD J. RUBIN
PERI N. NASH
SURREY & MORSE
1250 Eye Street, N.W.
Washington, D.C. 20005
(202) 682-4000

*Attorneys for
Independent Bankers
Association of America*

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. (202) 347-8203

BEST AVAILABLE COPY

22 p

TABLE OF CONTENTS

	Page
I. QUESTION PRESENTED	2
II. STATEMENT OF THE CASE	2
III. INTEREST OF AMICUS CURIAE	2
IV. ARGUMENT	3
A. Congressional Intent is the Overriding Consideration in Construing the Bank Holding Company Act	5
1. Overwhelming Case Precedent Compels the Board to Elevate Substance Over Form	6
2. The Amended Regulation Y Properly Addresses the Substance of Nonbank Bank Operation	10
3. Congress has Delegated to the Board the Exclusive Authority To Interpret 12 U.S.C. § 1841(c)	11
B. The Amended Regulation Y is Consistent with Congressional Intent in the BHCA and the Overall Federal Bank Regulatory Scheme	13
V. CONCLUSION	17

TABLE OF AUTHORITIES

CASES	Page
<i>American Bankers Association v. Connell</i> , 686 F.2d 953 (D.C. Cir. 1979)	10
<i>Board of Governors of the Federal Reserve System v. Agnew</i> , 329 U.S. 441 (1947)	11
<i>Board of Governors of the Federal Reserve System v. First Lincolnwood Corp.</i> , 439 U.S. 234 (1978)	11
<i>Board of Governors of the Federal Reserve System v. Investment Co. Institute</i> , 450 U.S. 46 (1981)	11
<i>Colorado ex rel. State Banking Board v. First National Bank of Fort Collins</i> , 540 F.2d 497 (10th Cir. 1976), cert. denied, 429 U.S. 1091 (1977)	9-10
<i>Consumers Union of United States, Inc. v. Heimann</i> , 589 F.2d 531 (D.C. Cir. 1978)	12
<i>Dimension Financial Corp. v. Board of Governors of the Federal Reserve System</i> , 744 F.2d 1402 (10th Cir. 1984), cert. granted, ____ U.S. ____, 105 S. Ct. 2137 (1985)	5, 6, 13
<i>First Bancorporation v. Board of Governors of the Federal Reserve System</i> , 728 F.2d 434 (10th Cir. 1984)	5, 13
<i>First National Bank in Plant City, Florida v. Dickinson</i> , 396 U.S. 122 (1969)	6-7, 8, 14
<i>Florida Department of Banking & Finance v. Board of Governors of the Federal Reserve System</i> , 760 F.2d 1135 (11th Cir. 1985)	7-8, 10, 13, 14, 15-16
<i>IBAA v. Conover</i> , No. 84-1403-CIV-J-12 (M.D. Fla. Feb. 15, 1985)	2, 16
<i>IBAA v. Smith</i> , 534 F.2d 921 (D.C. Cir.), cert. denied, 429 U.S. 862 (1976)	9, 12
<i>Illinois ex rel. Lignoul v. Continental Illinois Nat'l Bank & Trust Co.</i> , 536 F.2d 176 (7th Cir.), cert. denied, 429 U.S. 871 (1976)	9
<i>In re Permian Basin Area Rate Cases</i> , 390 U.S. 747 (1968)	11
<i>Lewis v. BT Investment Managers, Inc.</i> , 447 U.S. 27 (1980)	14

Table of Authorities Continued

	Page
<i>Missouri ex rel. Kostman v. First Nat'l Bank</i> , 538 F.2d 219 (8th Cir.), cert. denied, 429 U.S. 941 (1976) ..	9
<i>Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.</i> , 463 U.S. 29 (1983)	11-12
<i>Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System</i> , ____ U.S. ____, 53 U.S.L.W. 4699 (U.S. June 10, 1985)	11, 15
<i>Otero Savings & Loan Association v. Federal Home Loan Bank Board</i> , 665 F.2d 279 (10th Cir. 1981) ...	9-10, 12
<i>Securities Industry Association v. Board of Governors of the Federal Reserve System</i> , ____ U.S. ____, 104 S.Ct. 3003 (1984)	11
<i>Wilshire Oil Co. v. Board of Governors of the Federal Reserve System</i> , 668 F.2d 732 (3rd Cir. 1981), cert. denied, 457 U.S. 1132 (1982)	8, 11
STATUTES	
Administrative Procedure Act, 5 U.S.C. § 553 (1976) .	4
Bank Holding Company Act, 12 U.S.C. § 1841(c) (1976)	3, 4, 5, 13
Bank Holding Company Act, 12 U.S.C. § 1842(d) (1976)	2, 14
Bank Holding Company Act, 12 U.S.C. § 1844(b) (1976)	11, 13
National Bank Act, 12 U.S.C. § 36 (1976)	2, 9, 14
REGULATIONS	
Regulation Y, 12 C.F.R. § 225.2(a)(1)(A) & (B) (1985) ..	3-4
Revision of Regulation Y, Supplementary Information, Appendix A, 49 Fed. Reg. 833 (Jan. 5, 1984) .	6, 12, 17
LEGISLATIVE MATERIALS	
S. Rep. No. 1084, 91st Cong., 2d Sess., reprinted in 1970 U.S. CODE CONG. & AD. NEWS 5519	14
MISCELLANEOUS	
Scott, <i>The Patchwork Quilt: State and Federal Roles in Bank Regulation</i> , 32 STAN. L. REV. 687 (1980) ..	14

IN THE
Supreme Court of the United States

OCTOBER TERM 1985

No. 84-1274

BOARD OF GOVERNORS OF THE
FEDERAL RESERVE SYSTEM,

Petitioner,

V.

DIMENSION FINANCIAL CORPORATION, *et al.*,

Respondents.

On Writ of Certiorari to the United States Court of
Appeals for the Tenth Circuit

**BRIEF OF INDEPENDENT BANKERS
ASSOCIATION OF AMERICA
AMICUS CURIAE
IN SUPPORT OF PETITIONER**

The Independent Bankers Association of America ("IBAA") appears herein as *amicus curiae* pursuant to Supreme Court Rule 36.2. All parties have consented in writing to IBAA's participation as *amicus curiae* and to the filing of this brief.

I QUESTION PRESENTED

The IBAA adopts the Question Presented set forth in the Brief of the Board of Governors of the Federal Reserve System (the "Board").

II STATEMENT OF THE CASE

The IBAA adopts the Statement of the Case presented by the Board.

III INTEREST OF AMICUS CURIAE

The IBAA is a Minnesota non-profit corporation with headquarters in Washington, D.C. and offices in Sauk Centre, Minnesota. The IBAA represents over 7,400 commercial banks in 49 states and the District of Columbia, roughly half of all the banks in the United States. IBAA is committed to maintaining the principle that individual states have the right and responsibility to determine the structure of banking within their borders. This principle is embodied both in section 36 of the National Bank Act (the "McFadden Act"), 12 U.S.C. § 36, and section 3(d) of the Bank Holding Company Act of 1956, as amended, (the "Douglas Amendment"), 12 U.S.C. § 1842(d). IBAA further supports continued maintenance of the Congressionally mandated separation of banking from the activities of non-banking organizations as vital to the safety and soundness of the nation's banking system. IBAA has appeared as a party and as *amicus curiae* on numerous occasions in court actions and administrative proceedings relating to the preservation of these principles.

IBAA is currently a plaintiff in *IBAA, et al. v. Conover*, No. 84-1403-CIV-J-12, now pending before the United States District Court for the Middle District of Florida. In that case IBAA has challenged the authority of the Comptroller of the Currency of the United States, under the National Bank Act, to grant national bank charters to so-called "nonbank banks", because charter applicants for such institutions represent that

they will not engage in one or the other of the two traditional activities of commercial banking—the acceptance of demand deposits and the making of commercial loans. IBAA has alleged that the National Bank Act does not authorize the chartering of such institutions and that the sole purpose of their structure is to evade the definition of "bank" in the Bank Holding Company Act of 1956, as amended, 12 U.S.C. § 1841 ("BHCA" or the "Act"). Nonbank banks hope to avoid the jurisdiction of the Board and the BHCA's prohibitions against interstate ownership of banks and ownership by nonbanking organizations. On February 15, 1985, the Court granted IBAA's motion for preliminary injunction and enjoined the Comptroller from issuing final approvals for nonbank bank charters pending a decision on the merits.

IV ARGUMENT

It is submitted that organizations which offer both demand deposit and commercial lending services or, as amended Regulation Y provides, NOW accounts in lieu of checking accounts, and any type of loans other than personal loans, were intended by Congress to be included within the scope of the provisions of the BHCA and subject to Board jurisdiction.

The Board's revised Regulation Y, 12 C.F.R. § 225.2(a)(1)(A) & (B), interprets the definition of "bank" as set forth in the BHCA¹ to include services proposed to be offered by a growing

¹12 U.S.C. § 1841(c) defines "bank" as any institution which "(1) accepts deposits that the depositor has a legal right to withdraw on demand, and (2) engages in the business of making commercial loans."

Revised Regulation Y provides further detail regarding the statutory definition:

For the purposes of this definition:

(A) "Deposits that the depositor has a legal right to withdraw on demand" (hereinafter "demand deposits") means any deposit with transactional capability that, as a matter of practice, is payable on demand and that is withdrawable by check, draft,

number of nonbank banks that would otherwise have expected to escape Board regulation as "banks" under the BHCA by relying on a strictly technical reading of the section 1841(c) definition. As amended, Regulation Y includes as "banks" for purposes of the Act those institutions which both offer NOW accounts and make commercial loans, and those which both purchase short-term commercial obligations and offer checking accounts. The Board's interpretation thus brings the parent companies of such institutions within the jurisdiction of the Board and the regulations and restrictions imposed by the BHCA.

The Respondents, Dimension Financial Corp., *et al.*, have challenged the Regulation Y amendments on the grounds that: (1) The regulation is inconsistent with the letter and purpose of the BHCA; (2) the Board exceeded its authority in issuing its amended interpretation of the definition of "bank" in the BHCA; and (3) the Board failed to satisfy the rulemaking requirements of the Administrative Procedure Act, 5 U.S.C. § 553.

It is the position of IBAA that the Board acted well within the scope of its statutory supervisory authority and its administrative discretion to construe the Act so as to apply its coverage to financial institutions that are substantively within the meaning and intent of the provisions of the BHCA. Indeed, the Board's action was essential to protect the integrity of the BHCA and the existing structure of bank regulation from a

negotiable order of withdrawal, or other similar instrument; and

(B) "Commercial loans" means any loan other than a loan to an individual for personal, family, household, or charitable purposes, and includes the purchase of retail installment loans or commercial paper, certificates of deposit, bankers acceptances, and similar money market instruments, the extension of broker call loans, the sale of federal funds, and the deposit of interest-bearing funds.

12 C.F.R. § 225.2(a)(1).

wholesale evasion of the Act through the use of the nonbank device.

A. Congressional Intent is the Overriding Consideration in Construing the Bank Holding Company Act.

The U.S. Court of Appeals for the Tenth Circuit below relied on an overly narrow construction of "demand deposit" and "commercial loan" in holding that the Board lacked the authority to amend Regulation Y by expanding those definitions. *See Dimension Financial Corp. v. Board of Governors of the Federal Reserve System*, 744 F.2d 1402 (10th Cir. 1984), *cert. granted*, ____ U.S. ____, 105 S. Ct. 2137 (1985). If upheld, this formalistic approach would render the Board incapable of discharging its responsibilities under the BHCA to prevent, among other things, the concentration of banking resources through strict enforcement of the Act's limitations on interstate banking and on commingling of banking and non-banking activities.

The Tenth Circuit invalidated the Board's expanded definition of "demand deposit" solely on the strength of its own earlier decision in *First Bancorporation v. Board of Governors of the Federal Reserve System*, 728 F.2d 434 (10th Cir. 1984) (the *Beehive* case), without further discussion. *See* 744 F.2d at 1404, 1411.² In *Beehive* the court ruled that since the state law required that industrial loan companies reserve the right to require notice prior to withdrawal from NOW accounts, customers had no legal right to withdraw funds on "demand" and thus NOW accounts were not "demand deposits" under the BHCA. 728 F.2d at 436. This conclusion was reached despite the court's acknowledgment that withdrawals from NOW accounts were in actual practice permitted on demand. *See id.*

²In *Beehive*, the court overturned a determination by the Board that an industrial loan company that offered negotiable order of withdrawal ("NOW") accounts would be subject to the reserve and interest limitations applicable to "banks" under the BHCA. The *Beehive* court rested its decision on a strict construction of 12 U.S.C. § 1841(c). 728 F.2d at 436.

Addressing the second prong of the "bank" definition as interpreted in the Board's revised Regulation Y in this case, the Tenth Circuit invalidated the amendment on the ground that the expanded definition of "commercial loan" represented a "complete reversal" of the previously accepted meaning of that term, 744 F.2d at 1404, although the court was unable to point to any statutory authority or legislative history that provided a contrary interpretation of the meaning of commercial loan.³

1. Overwhelming Case Precedent Compels the Board to Elevate Substance Over Form.

In adopting a very literal approach to the meaning of "demand deposit" and "commercial loan" under the BHCA, the Tenth Circuit completely ignored—or subordinated—both express Congressional intent in enacting the BHCA and the purposes underlying the deliberate scheme of federal regulation of commercial banking. It is well established, however, that the courts may not exalt form over substance when to do so would subvert Congressional intent.

This specific principle was forcefully articulated by this Court under very similar circumstances in *First National Bank in Plant City, Florida v. Dickinson*, 396 U.S. 122 (1969).

³The court referred to several isolated Board letters and internal memoranda that had excepted particular transactions from the purview of "commercial loans" under the Act and that appeared to conflict with the Board's current interpretation. 744 F.2d at 1405-06. The court admitted, however, that the Board had already applied the broader definition, later embodied in Regulation Y, in the case of the Dreyfus Letter (December 1982). *Id.* at 1406.

Further, the Board established that it had previously maintained a consistent policy since 1971 of treating as commercial loans "all loans other than a loan the proceeds of which are used to acquire property or services used by the borrower for his own personal, family, or household purposes, or for charitable purposes." See Bank Holding Companies and Change in Bank Control; Revision of Regulation Y, Supplementary Information, Appendix A, 49 Fed. Reg. 833, 842 (Jan. 5, 1984) (hereinafter referred to as "Regulation Y, Supplementary Information").

The Court held that an armored car service and shopping center depository receptacles used to collect customer deposits were "branches" within the meaning and intent of the definition of "branch" bank in the McFadden Act, and thus prohibited by a Florida law outlawing branch banking. Despite the scrupulous efforts of First National Bank to draft contracts with its customers to avoid the literal language of the branch definition and thereby avoid treatment of these facilities as "branches", the Court held:

Here, penetrating the form of the contracts to the underlying substance of the transaction, we are satisfied that . . . the bank has, for all purposes contemplated by Congress . . . , received a deposit.

Id. at 137. The Court stressed that a major objective of the federal system of bank regulation is the maintenance of "competitive equality" between federal and state-chartered institutions. The Court ruled that Congress could not have intended a device designed to give a competitive advantage to national banks by evading the restrictions contained in federal regulation (here, the McFadden Act's prohibition on branch banking except as permitted to state chartered banks under state law) to escape regulation. *Id.* at 136-37.

The circuit courts have consistently applied the reasoning in *Plant City* to eliminate other similar devices especially designed to escape restrictions of the BHCA and the National Bank Act. Most recently in *Florida Department of Banking & Finance v. Board of Governors of the Federal Reserve System*, 760 F.2d 1135 (11th Cir. 1985) (the *U.S. Trust* case), the U.S. Court of Appeals for the Eleventh Circuit overturned Board approval of the application of a New York bank holding company (U.S. Trust) to expand the activities of its Florida non-banking subsidiary. U.S. Trust had sought to avoid treatment of the subsidiary as a "bank" under the BHCA by using the nonbank bank device, *i.e.*, the Board's approval was conditioned on the subsidiary's commitment not to make commercial loans. The Eleventh Circuit found that the "technical non-

conformity" with the BHCA's definition of "bank," which permitted U.S. Trust to circumvent the Douglas Amendment's prohibition on interstate ownership of banks, must be disregarded in favor of an examination of the substance of the facility's services and Congressional intent in enacting the prohibition. *Id.* at 1143-44.

The court in the *U.S. Trust* case cited the Third Circuit's decision in *Wilshire Oil Co. v. Board of Governors of the Federal Reserve System*, 668 F.2d 732 (3d Cir. 1981), *cert. denied*, 457 U.S. 1132 (1982), as further support for the principle that the substance of the transaction *must* govern over the form, in light of Congressional intent embodied in the BHCA to prevent the clear circumvention of regulatory limitations. *See* 760 F.2d at 1143-44. The court in *Wilshire* upheld a Board decision that Wilshire Oil Company's financial subsidiary was a "bank" under the BHCA, that Wilshire was therefore a "bank holding company" subject to the Board's jurisdiction and was engaged in both banking and non-banking activities in violation of the BHCA. The device used by the subsidiary for evading the BHCA's definition of "bank" was to change the rules regarding its checking accounts to reserve the right to require 14 days' notice prior to withdrawal of deposits, although it announced its intention not to exercise that right. The court stated:

While the language of the BHC Act may be the starting point in construing the statute, we may look beyond the plain language, if necessary, to ensure that application of the literal terms does not destroy the practical operation of the statute.

668 F.2d at 735. Going beyond a literal reading of the statute's language, the court held that Wilshire's subsidiary fell "within the category of institutions that Congress intended to include in its definition of 'bank'," *see id.* at 737-38, and that the Board had "properly 'penetrat[ed] the form of the contracts to the underlying substance of the transaction'," *see id.* at 740 (quoting *Plant City*).

Similarly, in a case involving the legal status under the National Bank Act of automated teller machines employed by

national banks to dispense cash and accept customer deposits ("CBCT's"), the D.C. Circuit court in *IBAA v. Smith*, 534 F.2d 921 (D.C. Cir.), *cert. denied*, 429 U.S. 862 (1976), stressed that the conduct of the parties and the practical nature of their relationships, not the formal structure of their private contractual agreements, must determine the nature of the transaction for review of statutory compliance. *See id.* at 942. The court further endorsed the principle that the regulatory agency *must* apply the purpose and intent of the statute over its literal terms. *Id.* at 942-44.

The U.S. Courts of Appeals for the Seventh and Eighth Circuits employed the identical substance-over-form analysis of *Plant City* to similarly determine that CBCT's in substance constituted "branches" under the McFadden Act, and therefore were subject to the restrictions on branching contained in the National Bank Act.⁴ Even the Tenth Circuit, prior to the *Beehive* decision, endorsed the same principle of statutory interpretation that the form of a transaction should not be permitted to govern over its substance when to do so would frustrate the intent of Congress. *Colorado ex rel. State Banking Board v. First National Bank of Fort Collins*, 540 F.2d 497, 499 (10th Cir. 1976), *cert. denied*, 429 U.S. 1091 (1977);⁵ *Otero*

⁴*See Illinois ex rel. Lignoul v. Continental Illinois Nat'l Bank & Trust Co.*, 536 F.2d 176 (7th Cir.), *cert. denied*, 429 U.S. 871 (1977) (cash withdrawal from a CBCT is the functional equivalent of a check; CBCT is in substance a "branch"); *Missouri ex rel. Kostman v. First Nat'l Bank*, 538 F.2d 219 (8th Cir.), *cert. denied*, 429 U.S. 941 (1976) (CBCT's in effect receive deposits and credit accounts and are therefore "branches").

⁵ The reasoning of the trial court in the instant case was that the manner in which Bank's CBCT permitted the withdrawal of prepackaged packets of money . . . and also permitted the transfer of funds from one account to another, did not constitute "checks paid" or "money lent" as those terms are used in 12 U.S.C. § 36(f). Such reasoning in our view unduly emphasizes form at the expense of substance and fails to follow the admonition of the Supreme Court in *Dickinson* that "§ 36(f) must not be given a restrictive meaning that would frustrate the Congressional intent this Court found to be plain in *Walker*

Savings & Loan Association v. Federal Home Loan Bank Board, 665 F.2d 279, 289-90 (10th Cir. 1981) (McKay, conc.); accord, *American Bankers Association v. Connell*, 686 F.2d 953 (D.C. Cir. 1979).

2. The Amended Regulation Y Properly Addresses the Substance of Nonbank Bank Operation.

The amended Regulation Y is fully consistent with the principle that the use of devices designed to evade—or having the effect of evading—prohibitions in the BHCA cannot be relied on to exempt organizations from regulation under the BHCA. The expanded definitions of “demand deposit” and “commercial loan” in Regulation Y are the result of the Board’s serious concern over the vast potential for evasion of the BHCA through the use of nonbank banks.⁶ The Board’s action in amending Regulation Y is a necessary and proper response to the threat of nonbank banks. From the standpoint of the regulatory purposes of the BHCA, if nonbanks operate for all practical purposes as banks—offering checking services to the public, making business loans, enjoying discount window access and federal deposit insurance, as well as access to the payments system—the BHCA requires that they be regulated as banks.

Contrary to the Tenth Circuit’s opinion below, the expanded definitions in Regulation Y do not represent “drastic changes” in the Board’s position as regulator. Rather, the Board’s actions were made necessary by the “avalanche of applications” to establish nonbank banks that have been filed with the Board and the Comptroller’s Office in the last two years. See *Florida Department of Banking v. Board of Governors*, 760 F.2d at

Bank [citation omitted].” The Congressional intent referred to in *Walker Bank* was to place national and state banks in a position of “competitive equality” insofar as branch banking is concerned.

540 F.2d at 499.

⁶See *Florida Dept. of Banking v. Board of Governors*, 760 F.2d at 1138 (quoting Board’s order of March 23, 1984 approving U.S. Trust application).

1138. The drastic change from prior Board policy would have occurred if the Board had *not* acted, thereby permitting departure from the traditional federal regulatory scheme imposing controls on concentration of banking resources and commingling of banking and nonbanking activities.

3. Congress Has Delegated to the Board the Exclusive Authority to Interpret 12 U.S.C. § 1841(c).

The Board has the power to issue regulations “necessary to enable it to administer and carry out the purposes of [the Act] and prevent evasions thereof.” 12 U.S.C. § 1844(b). Moreover, this Court has recently reaffirmed that the Board is “an authoritative voice on the meaning of a federal banking statute.” *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System*, ___ U.S. ___, ___, 53 U.S.L.W. 4699, 4701-02 (U.S. June 10, 1985) (citing *Securities Industry Association v. Board of Governors of the Federal Reserve System*, ___ U.S. ___, 104 S.Ct. 3003 (1984)). Great deference is due to the Board’s interpretation of a term in the BHCA designed to effectuate the underlying purposes of the Act.⁷

The Board also has the power to issue interpretations of statutory terms to address circumstances not anticipated when the statute was drafted. See *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 784 (1968) (“administrative authorities must be permitted . . . to adapt their rules and policies to the demands of changing circumstances”), quoted in *Motor Vehicle Manufacturers Association of the United States v. State Farm*

⁷See *Board of Governors of the Federal Reserve System v. Investment Co. Institute*, 450 U.S. 46, 56 (1981) (Board’s construction of provisions of the BHCA entitled to the “greatest deference”); *Board of Governors of the Federal Reserve System v. First Lincolnwood Corp.*, 439 U.S. 234, 251 (1978) (Board’s interpretation of its mandate under BHCA entitled to deference when that construction accords with Congressional goals); *Board of Governors of Federal Reserve System v. Agnew*, 329 U.S. 441, 450 (1947) (Rutledge, J., conc.) (Board’s judgment construing Glass-Steagall Act conclusive on any matter open to reasonable difference of opinion; deference due to Board’s specialized experience); *Wilshire Oil Co. v. Board of Governors*, 668 F.2d at 736 (construction of statute by those charged with its administration is entitled to substantial deference).

Mutual Automobile Insurance Co., 463 U.S. 29, 42 (1983); cf. *Consumers Union of United States, Inc. v. Heimann*, 589 F.2d 531, 534 (D.C. Cir. 1978) (it is proper to look beyond plain meaning of statute "notably when there is an assertion of a significant change in circumstances"); *IBAA v. Smith*, 534 F.2d at 943, 944 (broad definition of "branch" provides "flexibility necessary to adapt [the] statute to the technological innovations of the computerized Seventies"; construction of statute must be broad enough to encompass traditional banking functions carried out through technologically innovative mechanisms).

It is imperative that the federal banking regulatory agencies retain the power to respond with flexibility to banking innovations in order to preserve the basic objectives underlying the scheme of federal bank regulation, because

a debating body such as Congress [cannot] respond swiftly enough with regulations to accommodate the sophisticated devices designed by depository institutions to circumvent comprehensive legislation.

Otero Savings & Loan v. Federal Home Loan Bank Board, 665 F.2d at 289-90 (McKay, conc.). The amendments to Regulation Y constitute a valid exercise of the Board's discretionary authority to bring within the BHCA's regulatory framework the myriad sophisticated devices employed by organizations seeking to circumvent regulation.⁸

⁸The Board furnished a lengthy articulation of the bases for the expanded definition of "bank" under the BHCA. See Regulation Y, Supplementary Information, *supra*, 49 Fed. Reg. at 833-42. Throughout, the Board demonstrated the dramatic extent to which organizations have already employed new mechanisms to maximize the benefits of operation as commercial banks while minimizing the impediments of federal and state regulation, so as to gain competitive advantage. The Board explicitly characterized Regulation Y as an attempt to minimize the distortions created by these recent developments. See, e.g., *id.* at 842:

Now that conditions have changed so that widespread evasion of the statute has developed through the combination of demand deposit-taking and the placing of funds thus generated in money market commercial loans, regulatory action to apply the Act to all kinds of demand deposits and commercial loans is necessary.

Consider the Board's dilemma in attempting to control the proliferation of nonbank bank devices and the wholesale circumvention of the safeguards of the BHCA. First, it sought to recognize and treat NOW accounts as the practical equivalent of demand deposit accounts under the BHCA's "bank" definition. The Tenth Circuit in the *Beehive* case reversed the Board and held that the Board could not do so without the promulgation of a substantive rule. *First Bancorporation v. Board of Governors*, 728 F.2d at 438. The Board issued revised regulation Y in order to clarify the definitions of "demand deposits" and "commercial loans" under the BHCA. The Tenth Circuit again reversed, holding this time that the Board had exceeded its authority in interpreting 12 U.S.C. § 1841(c). *Dimension Financial Corp. v. Board of Governors*, *supra*, 744 F.2d at 1410. Pursuant to the Tenth Circuit's directive in *Beehive*, the Board reluctantly approved U.S. Trust's nonbank bank application, only to then be told by the Eleventh Circuit that it should have disapproved the application pursuant to the Board's power under 12 U.S.C. § 1844(b) to "prevent evasion . . . of the fundamental purposes of the Act." *Florida Department of Banking v. Board of Governors*, 760 F.2d at 1143.

The Tenth Circuit is clearly wrong in its narrow view of the Board's discretionary authority to interpret the BHCA. In the *U.S. Trust* case, the Eleventh Circuit properly interpreted and applied the legislative history of the BHCA and its consistent judicial interpretation prior to *Beehive* and *Dimension* to permit the Board, if necessary, to go even further to prevent evasions of the Act.

B. The Amended Regulation Y is Consistent with Congressional Intent in the BHCA and the Overall Federal Bank Regulatory Scheme.

Congress' three major purposes in adopting the BHCA and its various amendments were: (1) to prevent the "concentration of banking resources in the hands of a few financial giants" and the consolidation of banking facilities within a

particular area; (2) to guard against the potential abuses inherent in the commingling of banking and nonbanking enterprises; and (3) to prohibit the creation of interstate deposit-taking networks except as specifically authorized by state law.⁹ See *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 46 (1980); *Florida Department of Banking v. Board of Governors*, 760 F.2d at 1141.

The potential for concentration of financial resources has been a chief concern of Congress since the 1930's. The controls on concentration contained in the BHCA further the overall congressional objectives of promoting competition in national credit markets,¹⁰ and protecting both individual depositors and the entire financial system from sharp and unintended contractions in the money supply due to bank failures.¹¹ Congress has sought to restrict joint control over banking operations and nonbanking activities because of potential abuses, such as favoritism in commercial lending toward banks' commercial and industrial affiliates, tying arrangements requiring bank customers to purchase goods and services of banks' commercial affiliates, improper risk-taking by banks, and conflicts of interest. See, e.g., S. Rep. No. 1084, 91st Cong., 2d Sess., reprinted in 1970 U.S. CODE CONG. & AD. NEWS 5519, 5521-23. Statutory limitations on interstate banking are designed to further a

⁹The BHCA's limitations on interstate banking parallel the limitations on branch banking of the McFadden Act, 12 U.S.C. § 36. This Court in *First National Bank in Plant City v. Dickinson*, *supra*, conclusively established that the dual banking system was intended to foster "competitive equality" between federally chartered banks on the one hand and state banks on the other, and that the mechanism selected to achieve this goal was referral to state regulation on the question of branching. 396 U.S. at 131, 133. The Douglas Amendment to the BHCA, 12 U.S.C. § 1842(d), is part and parcel of the dual banking structure, and similarly supports state control over state banking structure. See *Florida Dept. of Banking v. Board of Governors*, 760 F.2d at 1141.

¹⁰See *Lewis v. BT Investment Managers, Inc.*, 447 U.S. at 46.

¹¹See Scott, *The Patchwork Quilt: State and Federal Roles in Bank Regulation*, 32 Stan. L. Rev. 687, 696 (1980).

consistent Congressional policy favoring state control over local bank structure by deferring to the states the decisions on entry by out-of-state banking organizations and the availability and expansion of branches. See *Northeast Bancorp, Inc. v. Board of Governors*, 53 U.S.L.W. at 4703.¹²

When a device formulated solely to take advantage of a technical loophole in the definition of "bank" under the BHCA — and which admittedly serves no other purpose — effectively undermines any one of the three basic policies of the BHCA, the bank regulatory system cannot tolerate the evasion. In the *U.S. Trust* case, the court refused to be bound by a literal reading of the Act that was plainly at variance with Congressional policy and that would produce absurd results:

[W]e now consider the question of whether it is reasonable to conclude that Congress intended in 1970 to destroy the Douglas Amendment by adopting an amendment to the definition of bank which would permit bank holding companies to establish an unlimited number of deposit-taking banks across state lines without state approval . . . We cannot persuade ourselves to employ literalism in statutory interpretation in order to bootstrap Congress' technical amendment of the definition of bank—after being told that the amendment would apply to only a single

¹²This Court recently spoke authoritatively on the subject of the purposes of the Douglas Amendment to the BHCA and the McFadden Act. In the *Northeast Bancorp* case, the Court reaffirmed that Congress intended to allow states flexibility in their approach to interstate banking, and that a primary objective of the BHCA is to "retain local, community-based control over banking." 53 U.S.L.W. at 4703. The Court quoted with approval a commission's report to the Connecticut General Assembly that characterized the federal system of bank regulation as a "pluralistic banking system," designed to preserve a close relationship between the sources of credit and the small and medium-sized businesses, as well as individual citizens, that are in need of credit. *Id.*; accord, *Florida Dept. of Banking v. Board of Governors*, 760 F.2d at 1143 (federal policy favors state control over expansion of out-of-state bank holding companies; "local funding of local projects is a significant and important incident of state control over banking").

institution—into a total emasculation of the long held policy giving states control over bank expansion.

760 F.2d at 1141 (emphasis added).

The foundation of the court's reasoning in *U.S. Trust* is that Congress could not have intended such wholesale evasion of the BHCA's limitations on interstate banking in the absence of any clear expression of such intent. *See id.* at 1142. The various forms of nonbank banks are all designed to skirt one or another of the major restrictions of the BHCA —limits on concentration, limits on commingling of banking and nonbanking activities, or limits on interstate banking. The Board's goal in amending Regulation Y was to interpret and clarify the definition of "bank" in such a way that those institutions engaging in activities that were intended to be included in the coverage of the BHCA do not evade the Act's clear restrictions. Very clearly, the sole purpose of any nonbank bank is to circumvent one or another limitation contained in the BHCA. The only purpose in forswearing either commercial lending or traditional demand deposits by these organizations is to avoid the limitations on interstate banking or the separation of banking and commerce set forth in the Douglas Amendment.¹³

The Board's attempt to restore regulatory equilibrium by including in the coverage of the BHCA financial institutions that offer deposit accounts that operate as demand deposit accounts and engage in transactions that establish a debtor-creditor relationship with commercial enterprises was a proper

¹³The court in *IBAA v. Conover*, specifically addressed this issue:

The Comptroller does not serve the public interest by issuing charters to nonbank banks when their only conceivable purpose is to enable their parent companies to escape regulation under the BHCA.

Memorandum Opinion and Order on Defendant's Motion to Dismiss and on Plaintiff's Motion for Preliminary Injunction, *IBAA v. Conover*, No. 84-1403-CIV-J-12, slip op. at 39 (M.D. Fla. Feb. 15, 1985).

exercise of its discretionary authority. The Board must have the authority to act swiftly and decisively to keep pace with financial sector innovations "in order to avoid the preemption of Congressional discretion through actions that have the effect of evading the [BHCA]." *See* Regulation Y, Supplementary Information, *supra*, 49 Fed. Reg. at 842.

V CONCLUSION

The decision of the U.S. Court of Appeals for the Tenth Circuit below improperly exalts a literal reading of one section of the BHCA over the purpose of the Act itself, and unwisely disregards the fundamental objectives of the entire scheme of federal bank regulation. This Court must uphold the Board's necessary actions to preserve and protect the integrity of the BHCA and the federal structure of bank regulation.

Respectfully submitted,

LEONARD J. RUBIN
PERI N. NASH

SURREY & MORSE
1250 Eye Street, N.W.
Washington, D.C. 20005
(202) 682-4000

*Attorneys for
Independent Bankers
Association of America*

Dated: July 12, 1985